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ECONOMIC TRENDS

INFLATION AND THE P.E.I. ECONOMY

1. Introduction

The first Economic Trends paper produced in May 1980 addressed the subject of inflation, given its extreme importance for economic policy. It is timely to review trends since then in view of the apparent success of anti-inflationary policies in recent months. Table 1 displays annual percentage changes in the Consumer Price Index for Charlottetown-Summerside and Canada from 1971, where it is

Table 1
Annual % Changes in the
Consumer Price Index

	<u>Charlottetown-</u> <u>Summerside</u>	<u>Canada</u>
1971	n.a.	2.9
1972	n.a.	4.8
1973	n.a.	7.5
1974	n.a.	10.9
1975	11.4	10.8
1976	7.7	7.5
1977	8.1	8.0
1978	8.0	9.0
1979	8.6	9.1
1980	10.4	10.1
1981	13.5	12.5
1982	9.5	10.8
1983 1Q*	6.3	7.6

* Compared to 1 Quarter 1982.

Source: Statistics Canada, 62-001

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apparent that inflationary conditions peaked in 1981 and have fallen to a low of 6 per cent to 7.6 per cent in the first quarter of this year.

Three interrelated forces have been at work to produce the strong inflationary pressures of the late 70's: (a) a general slowing in economic growth throughout the western world culminating in a major decline in 1982; (b) the upward shift in oil and gas prices; and (c) efforts by society to sustain income growth despite reduced economic growth. Economic policies in this period in Canada and the western world largely focussed on controlling the growth of money supply in order to moderate inflation and this produced an extraordinary period of soaring interest rates in 1981 which in turn brought about the severe economic recession of late 1981 and 1982. These events had a direct impact on inflationary trends.

The decline in the rate of inflation in Canada since 1981 can also be attributed to three basic reasons: (1) the pattern of the major upward shift in energy prices in Canada from 1979 to 1982; (2) extremely moderate increases in food prices during 1981, followed by an absolute price decline in the latter half of 1982; and (3) generally depressed economic conditions coupled with active policies of wage restraint in the public sector.

In Table 2, one can see the percentage changes in food, energy, and non-food and energy items of the Consumer Price Index by year and by quarters for Canada. Price increases for non-food and energy items continued at a fairly high rate throughout 1982 and the reduction in this underlying inflationary measure occurred only in the early part of 1983. More important to the trend in price increases was the food and energy price situation. The extraordinary increase in energy prices that occurred in 1980-81 distinctly slowed in 1982 and more or less halted in the first quarter of 1983. Food price increases averaged only 7.2 per cent in 1982, fell in the fourth quarter of 1982 and were very small in the first quarter of 1983.

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Table 2

Annual and Quarterly Increases in Selected Items
of the Consumer Price Index, Canada

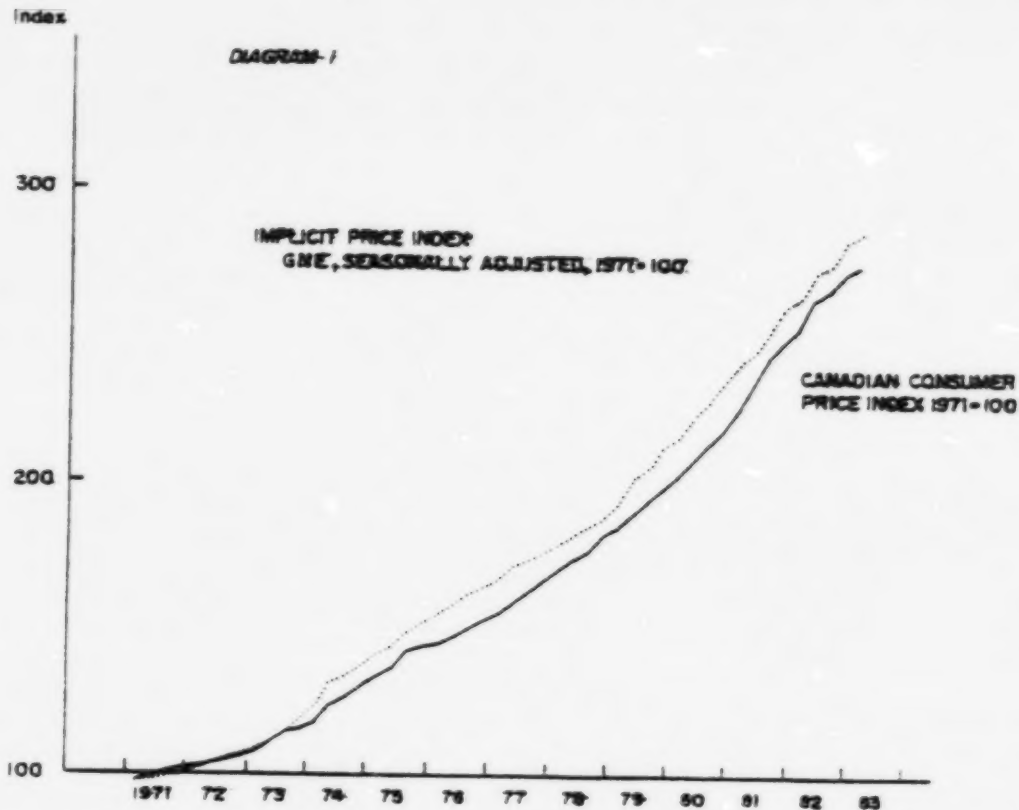
	<u>Total CPI</u>	<u>Food</u>	<u>Energy</u>	<u>CPI Less Food & Energy</u>
1972	4.8	7.6	2.9	3.8
1973	7.6	14.6	9.0	4.7
1974	10.9	16.3	15.2	8.3
1975	10.8	12.9	13.6	9.6
1976	7.5	2.7	15.4	8.7
1977	8.0	8.3	12.1	7.4
1978	8.9	15.5	9.3	6.1
1979	9.2	13.2	9.8	7.6
1980	10.2	10.7	16.0	9.4
1981	12.5	11.4	30.0	10.9
1Q	12.9	12.2	38.4	10.1
2Q	12.5	9.2	26.1	11.7
3Q	11.8	10.1	25.6	11.0
4Q	9.8	-2.1	17.1	12.9
1982	10.8	7.2	19.8	10.8
1Q	10.1	7.6	19.9	9.3
2Q	12.2	16.3	19.7	10.2
3Q	8.6	7.7	10.9	8.4
4Q	6.4	-4.1	9.5	9.3
1983				
1Q	2.5	1.5	0.6	3.1

Quarterly Increases identify quarter to quarter changes multiplied by four.

Source: Statistics Canada 62-001

It is often not understood that a falling rate of inflation continues to measure upward shifts in consumer prices and does not mean that prices are falling. Furthermore, during a period such as we have experienced with major upward shifts in prices each year, percentage rates of change can be somewhat misleading.

Thus in Diagram 1 we have portrayed the actual price index for Canadian consumer prices as well as the price index for Gross National Expenditures, up to the first quarter of 1983. The reduction in the rate of inflation has caused the slope of the line to soften somewhat but clearly prices are continuing to rise rapidly in absolute terms.



Source: Stats. Can. 13-001, G2-001

This issue of Economic Trends compares Prince Edward Island's experience with Canada generally and other selected provinces. By and large, the Province of Prince Edward Island does not appear to have suffered as badly as other provinces in many ways during this period. Generally speaking economic growth in eastern Canada slowed after 1976 while the Province of Alberta expanded very quickly from 1977 to 1981. The

manufacturing centres of Canada appear to have been particularly badly hit by prevailing economic conditions. Market conditions for food producers were, as was noted, fairly buoyant until late 1981 and were particularly good for P.E.I. potato farmers in 1980 and 1981.

In 1982 the major recession affected all provinces and all industries, with a particularly sharp decline in Alberta which had experienced strong growth in the years to that point. Despite slumping potato prices, the P.E.I. economy did not appear to experience such a precipitous industrial decline as occurred through most of Canada in 1982.

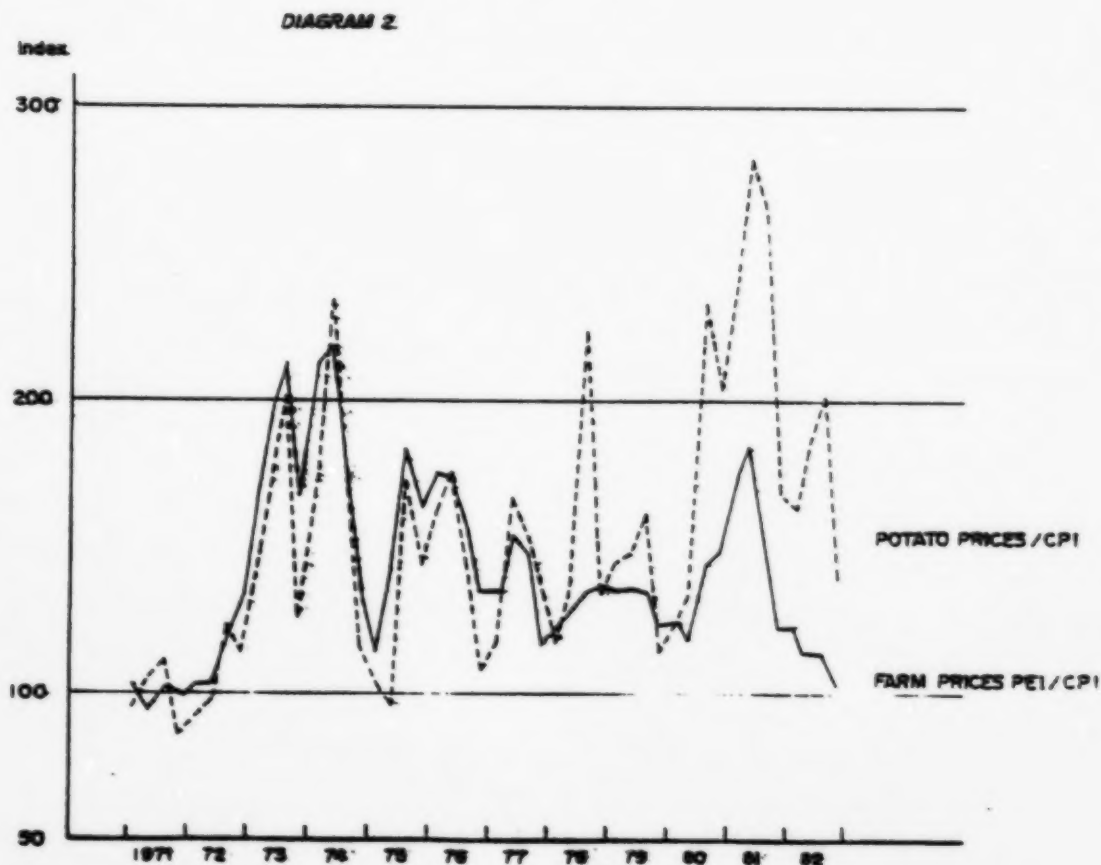
2. Primary Food Producer Prices

At the time of writing the initial Economic Trends paper on Inflation in early 1980 it appeared that farm price conditions on Prince Edward Island were gradually deteriorating from the peaks that had occurred in 1973 and 1974. However, as Diagram 2 indicates, the situation improved significantly in late 1980

Farm Price Index, P.E.I. and Potato Price

Component of Canadian CPI, Divided by All Items CPI

1971 = 100

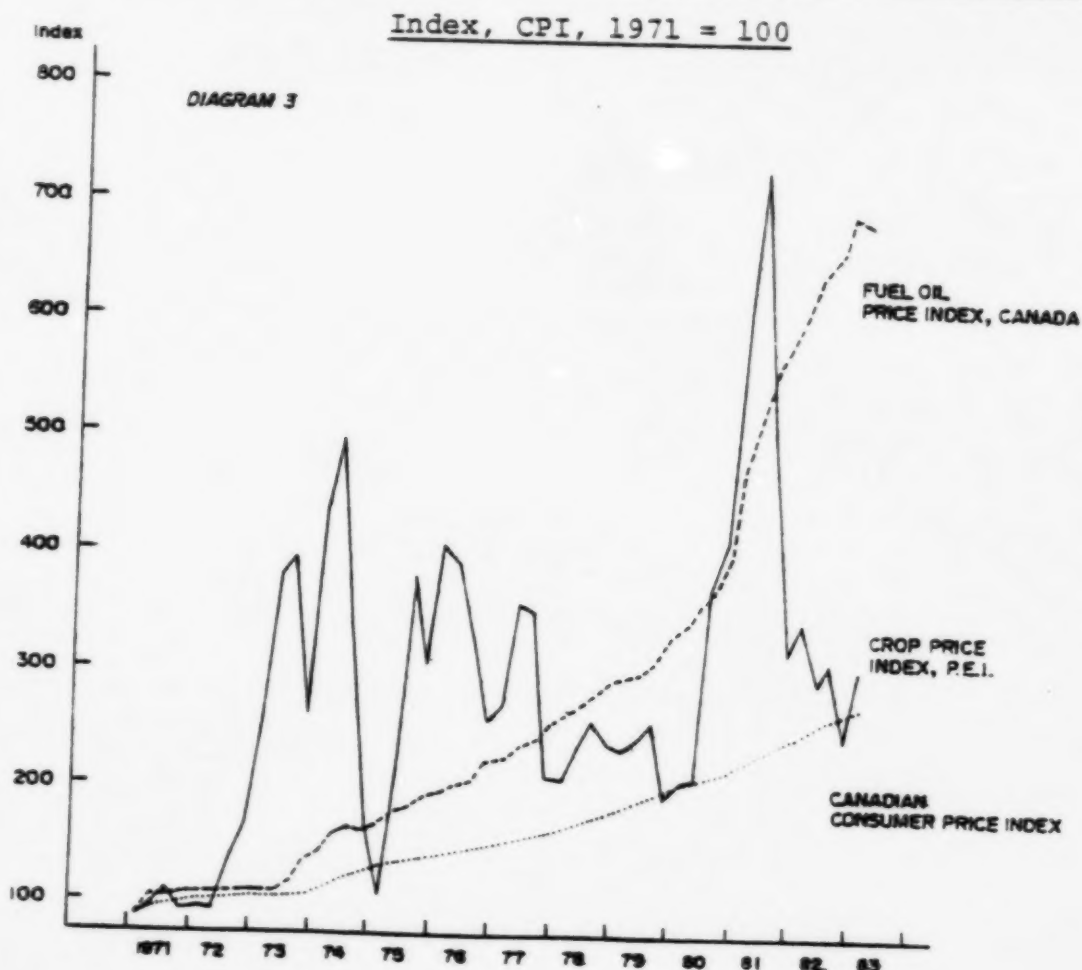


Source: Stats Can. 62-001, CANSIM 239102

through to mid 1981, when farm prices on Prince Edward Island followed Canadian potato prices generally. The price movements indicated in Diagram 2 are shown relative to changes in the Consumer Price Index as portrayed in Diagram 1. One can see that with the exceptions of 1971, early 1975 and late 1982, farm prices for Prince Edward Island farmers have been considerably above the general movement in consumer prices in Canada since 1971. The influence of potato prices in Canada, particularly in the early years is also noticeable.

Looking more closely at potato prices on Prince Edward Island, Diagram 3 compares the price index for crops on Prince Edward Island (principally potatoes), the price index for fuel oil in Canada (in the Consumer Price Index) and the general Canadian Consumer Price Index. One can note the extraordinary

Fuel Oil Component of Canadian CPI, P.E.I. Crop Price

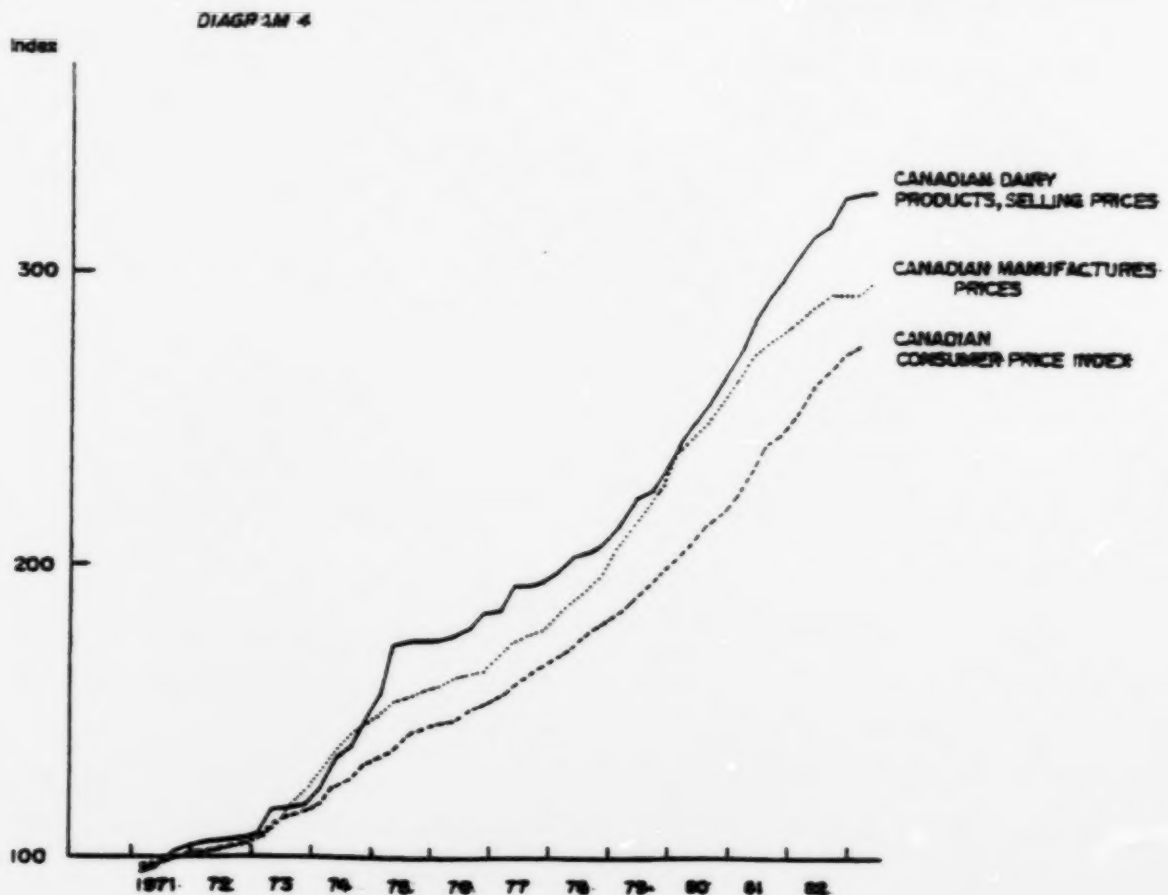


Source: Stats Can. 62-001, CANSIM 239103

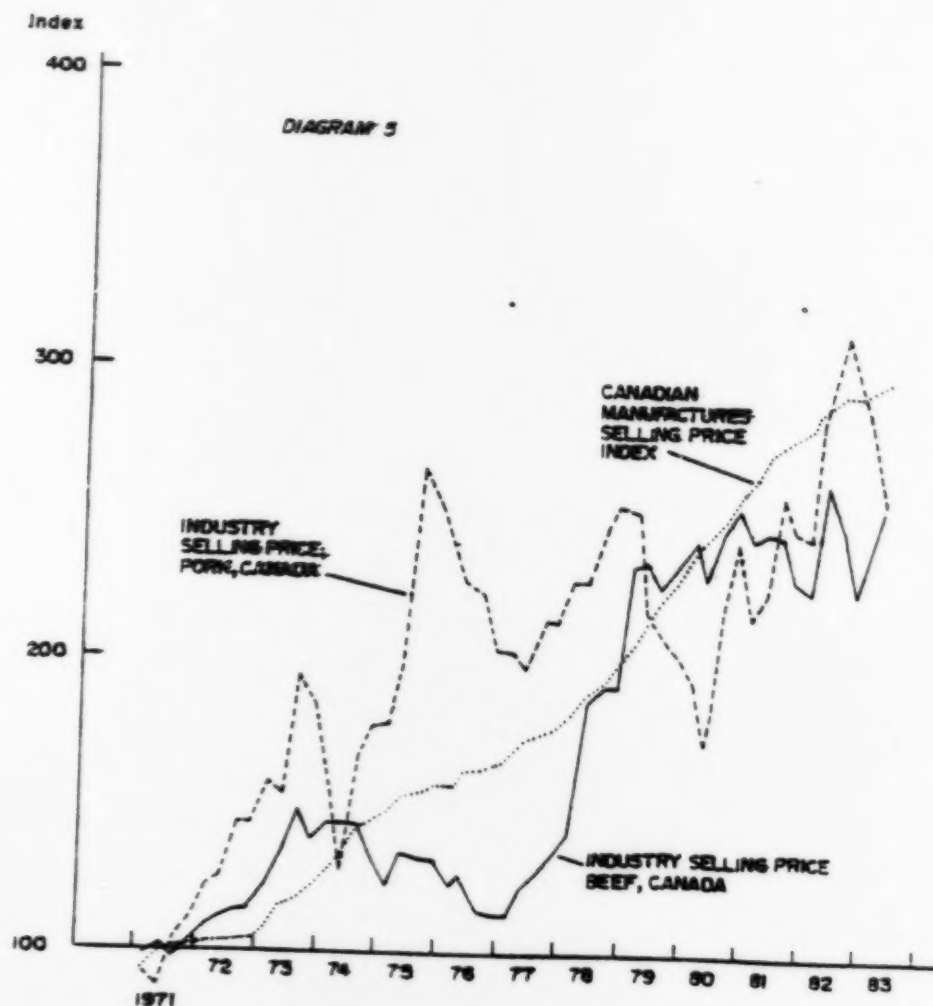
upward movement in potato prices in late 1980 and mid-1981 which at that time even exceeded the increases in fuel oil prices that were occurring, followed by their fall in late 1981 and 1982.

With respect to energy price increases one can see in Diagram 3 that fuel oil prices moved up sharply in 1973 and 1974 as a result of the initial OPEC pricing arrangements. Despite the efforts of the Federal Government to moderate domestic oil price increases Canadian oil prices have more or less tracked international oil prices, with some delays. A noticeable aspect of the recent history of price movements is that the upward shifts in energy prices have occurred coincidentally with major upward shifts in potato prices both in 1973 and 1980. It appears that the price of these staple products have become particularly sensitive to the economic circumstances of the 1970's and the 1980's. The record potato harvests of 1981 and 1982 on Prince Edward Island witnessed significant reductions in prices although the upturn in potato prices of early 1983 signifies continued market strength.

In Diagram 4 one can compare the price of dairy products in Canada with manufactured goods generally and the Canadian consumer price index is also portrayed. It might be noted that



the scale of this Diagram is considerably different than that of Diagram 3 and clearly the history of price movements of dairy products is quite different from that of P.E.I. crops. It would appear that dairy product prices have maintained a lead over those of manufactured goods generally and consumer prices throughout the period under study. The price picture presented is predictable in view of the largely regulated nature of this industry. In contrast to the price situation facing potato producers and dairy farmers, the situation for the beef and pork producers has also been quite different, as can be seen in Diagram 5. The rapid upward movement in beef prices that occurred 1971-1973 was followed by three years of general absolute declines. A major upward shift in beef prices occurred 1977-1979 but since that point prices have generally

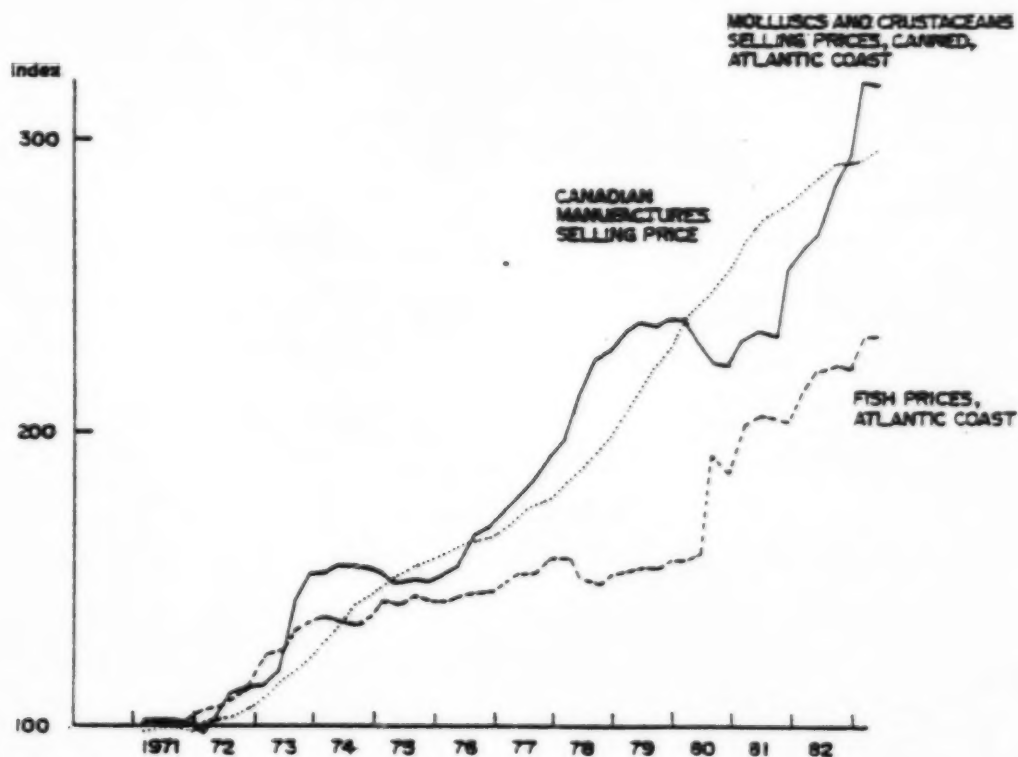


Source: Stats. Can. 62-011.

not kept pace with prices of manufactured goods on average. The hog industry witnessed significant upward shifts in pork prices 1971-1973, 1974-1975, 1977-78 and 1981-1982 with a subsequent decline in the early part of 1983. Both pork and beef producers have been subject to volatile price conditions.

The price situation for fish producers in Atlantic Canada was generally weak until 1980, as is apparent in Diagram 6. By contrast the market conditions for molluscs and crustaceans (basically lobsters on P.E.I.) has been more buoyant. A decline from 1979 to 1981 was reversed in 1982 and prices have kept pace with those of manufactured goods generally.

DIAGRAM 6



Sources: Stats. Can. 62-011.

One can observe significant differences in the price performance of different P.E.I. industries. Consequently it is difficult to generalize on this subject. Over the longer term, one can see in Table 2 that increases in prices of food

items have been a major factor in inflationary trends in the 1970's through to 1981 with the exception of 1976. In only four of those eleven years were food prices in the single digit range. Those years witnessed some remarkable upward movements in potato prices and the situation for dairy producers has generally been positive. Despite the fall in potato prices in 1982, if conditions continue in the 1980's as they have been in much of the past eleven years we are likely to witness further precipitous escalations and reversals in prices of farm products and continued dramatic swings in farm incomes on Prince Edward Island.

3. Wages and Salaries and Incomes

The economic conditions of the 1970's and early 1980's have clearly had a significant influence on income growth. In Table 3 the annual growth rate of Gross National Product from 1971 to 1982 and growth in consumer prices are shown. The economic growth that was occurring 1971-1973 came at the end

Table 3

	<u>% Growth of</u> <u>GNP, const. \$</u> <u>Canada</u>	<u>% Change</u> <u>in CPI</u> <u>Canada</u>
1971	6.9	2.9
1972	6.1	4.8
1973	7.5	7.5
1974	3.6	10.9
1975	1.2	10.8
1976	5.8	7.5
1977	2.0	8.0
1978	3.6	8.9
1979	3.2	9.2
1980	1.0	10.2
1981	3.4	12.5
1982	-4.4	10.8

Source: Stats. Can. 13-201, 13-001, 62-001.

of a twelve-year period of significant growth, starting in 1961, during which time increases in Canadian Gross National Product in constant dollars averaged 5.8 per cent per year. By contrast, growth of Gross National Product in constant dollars 1974 to 1981 averaged only 3 per cent per year, falling into the major recession of 1982. The influence of these conditions on

employment earnings can be traced in Table 4, which shows annual percentage increases in average weekly wages and salaries for the Industrial Composite on Prince Edward Island, and Canada.

Table 4
Annual Percentage Increases in
Average Weekly Wages and Salaries,
Industrial Composite, P.E.I., Canada,
and Changes in Canadian CPI

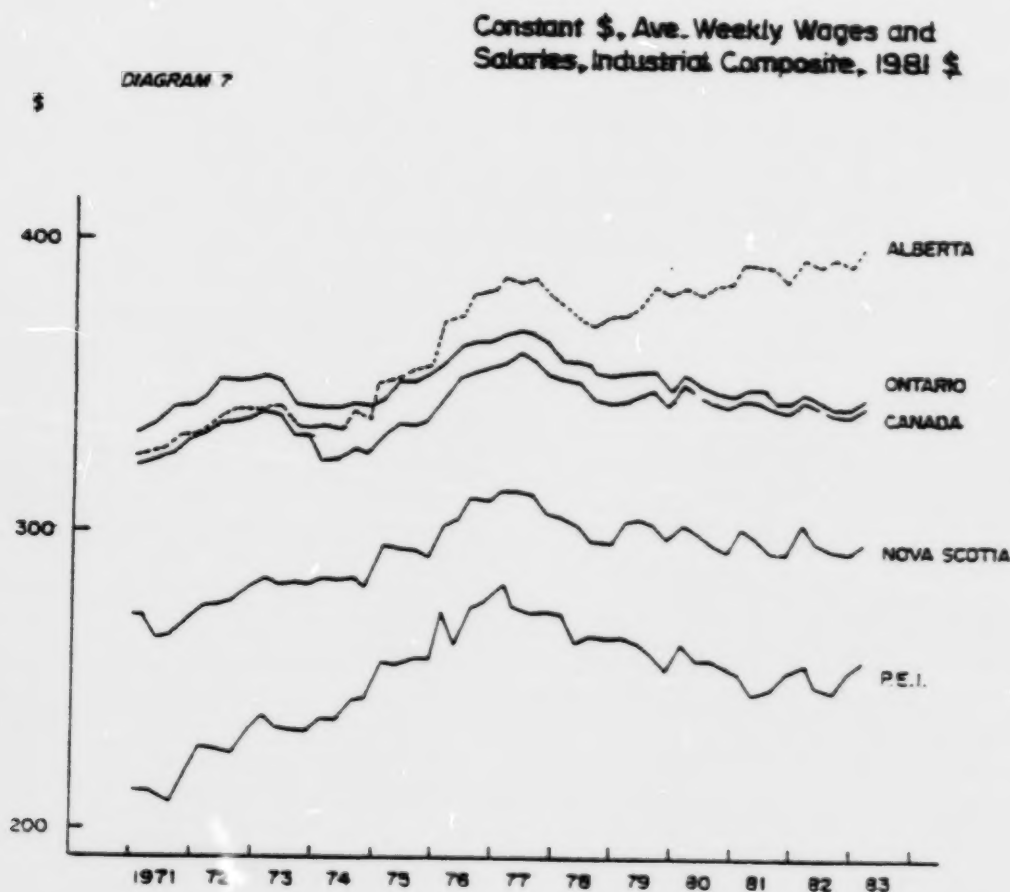
	<u>P.E.I.</u>	<u>Canada</u>	<u>CPI</u>
1972	12.3	8.4	4.8
1973	10.1	7.6	7.5
1974	14.1	11.0	10.9
1975	18.1	14.2	10.8
1976	14.1	12.2	7.5
1977	10.0	9.6	8.0
1978	4.8	6.2	8.9
1979	6.7	8.7	9.2
1980	9.7	10.1	10.2
1981	8.7	11.9	12.5
1982	11.4	10.2	10.8
1983 1Q	7.6	6.9	7.6

Source: Stats Can. 62-001, 72-002.

It can be seen that annual increases in average weekly wages and salaries on Prince Edward Island were consistently ahead of those of Canada during the early 1970's as well as being considerably in excess of increases in consumer prices. This significant increase in wages and salaries was noted in the Economic Trends paper #17 on personal income growth on Prince Edward Island and they peaked in 1975 at 18.1 per cent.

A distinct slowdown in wage and salary settlements occurred in 1978 in Canada leading to a further escalation up to 1981. Since 1978 earnings did not keep abreast of prices, except for P.E.I. in 1982.

In Diagram 7 we have portrayed the average weekly wage and salary data for the Industrial Composite for Canada, P.E.I. and selected provinces adjusted for increases in consumer prices.

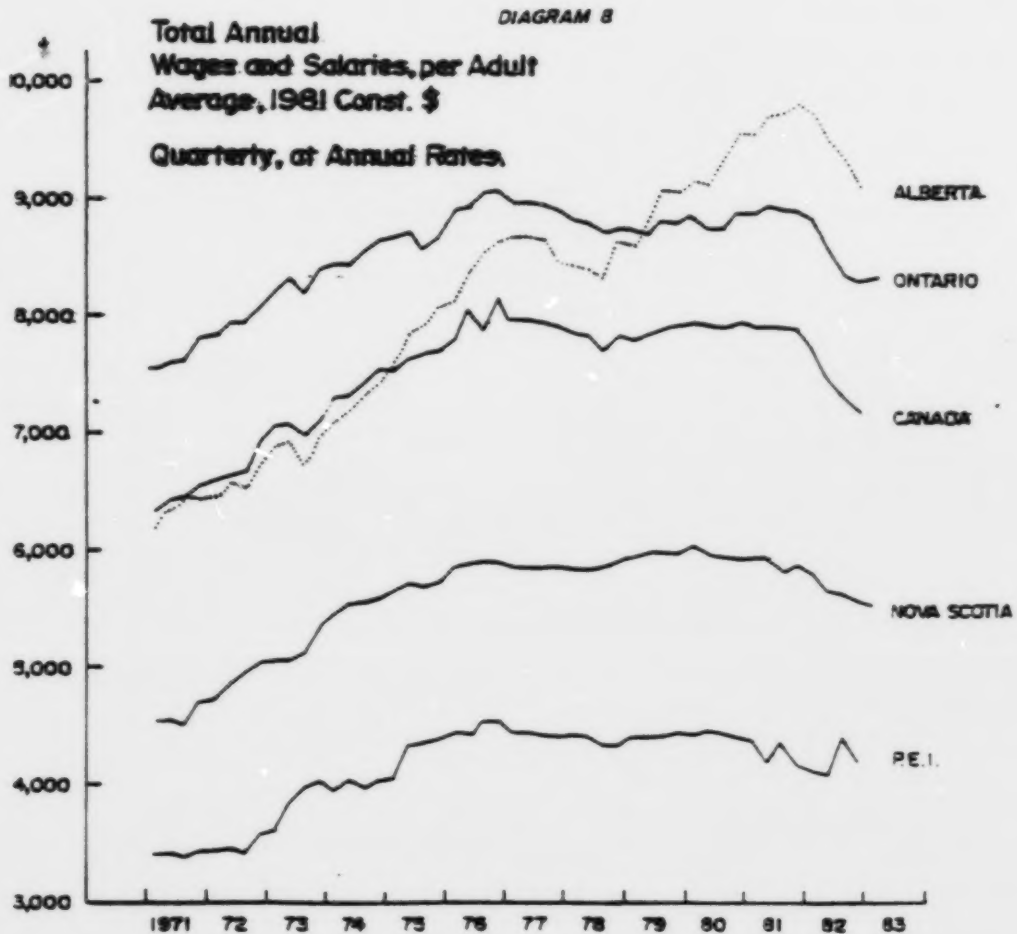


Sources: Stats Can. 62-001, 72-002.

The generally weakened conditions throughout eastern Canada reduced weekly wages and salaries in constant dollars from 1976 to 1982. Alberta experienced a totally different situation as wages and salaries continued to climb. Both the escalation in

constant dollar wages and salaries on Prince Edward Island and its subsequent decline after 1976 are noticeable in this diagram.

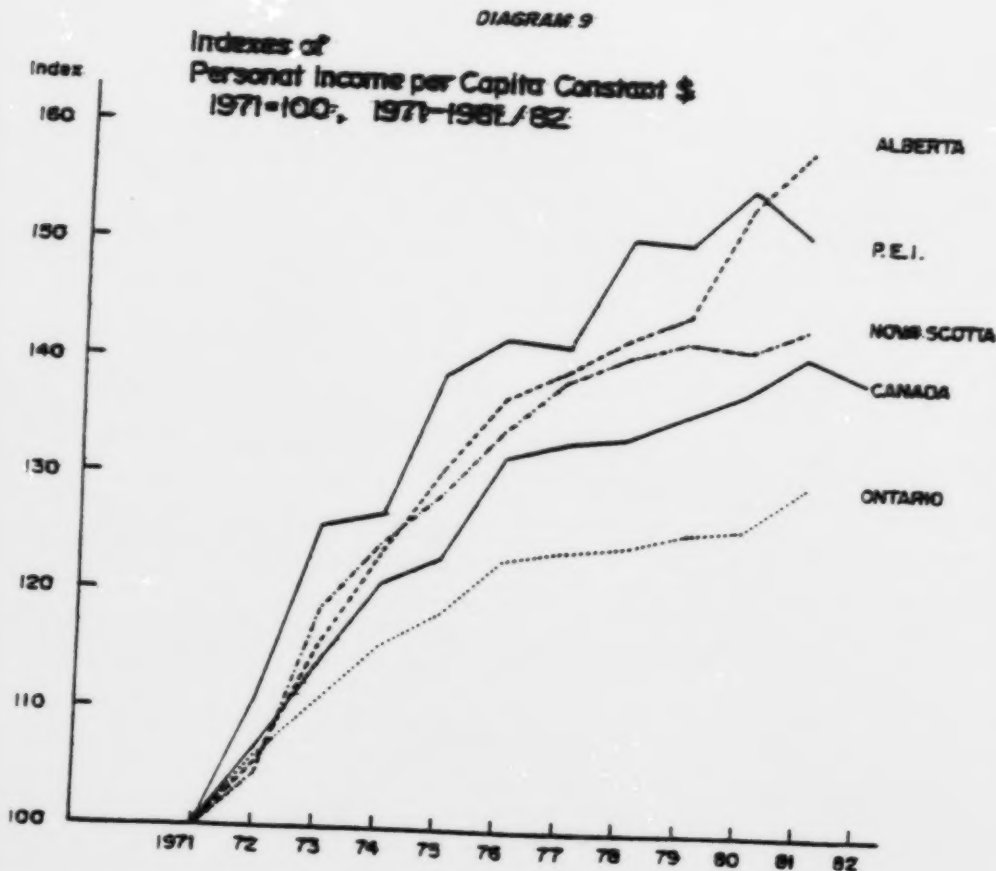
Looking at the question of increases in wages and salaries from a broader perspective, in Diagram 8 we have portrayed total wages and salaries earned on P.E.I., in constant dollars, per person over 15 years of age. There are two significant differences



Sources: Stats Can. 72-005, 71-001, 62-001.

between diagrams 7 and 8. The weekly wages and salaries data in 7 shows earnings of employees in the Industrial Composite, i.e. larger private companies. The total wage and salary statistics includes all industries, including government and private. By dividing by the total population 15+ we can see the impact of reduced earnings per person. This diagram discloses not only the fact that wages and salaries per capita in eastern Canada slipped relative to consumer prices but that a major deterioration occurred in Ontario in 1982 which was also shared by Alberta while P.E.I. was a noticeable exception to this phenomenon. Comparing Diagram 7 and Diagram 8 suggests that the major adjustment to the economic downturn of 1982 was through the creation of unemployment rather than a downward adjustment in wages and salaries of employees.

The weak growth of wages and salaries as a component of personal incomes in the late 70's was noted in issue #17 of Economic Trends. The overall growth of personal incomes in constant \$ on Prince Edward Island since 1971 can be compared to other provinces in Diagram 9. One should bear in mind that the actual level of income is not identified in this Diagram but for P.E.I. it is approximately 70 per cent of the Canadian



Sources: Stats Can. 13-201, 71-001.

average. For Canada one can note the major gains in real incomes that occurred in the early 1970's, which gave way to a very modest increase 1976-1981, falling into absolute decline in 1982. The Province of Ontario experienced the weakest growth since 1971, primarily as a result of the weak growth of wages and salaries. The exception to this picture was Alberta whose economy expanded at a rapid rate after 1979. P.E.I.'s situation did not appear to deteriorate to the degree of Ontario or Nova Scotia for four basic reasons: (1) the improved prices of primary products in 1980 and 1981 which were described earlier; (2) major growth in incomes on P.E.I. from investment and interest income; (3) the continued growth of transfer payments whose importance is relatively greater in view of generally low incomes on P.E.I.; and (4) the relatively smaller size of wages and salaries in the economy of P.E.I.. It might be pointed out that the heavy reliance on monetary policy by the Canadian Government in the late 1970's and early 1980's produced the significant increase in income from interest earnings.

4. Summary and Conclusions

A critical question to be faced at present is whether the emerging situation of less inflation represents a lull in inflationary trends or are we moving to a new period of long-term stability in prices? The immediate prospects for economic recovery without a major upturn in inflation appear promising. Probably the major reason for this is the generally depressed world economic situation and high unemployment rates which have both reduced demands for oil and gas and reduced pressures to increase wages.

The longer-term issue is whether the Canadian economy can successfully adapt to high energy costs and whether the public in general can accept reduced increases in money incomes. There can be little doubt that the economic stresses of the late 1970's will only re-emerge if the condition of the mid 1970's are repeated. Also, the Canadian economy appears to have moved into a period of slow economic growth over the longer term although this could change if the United States economy moves forward quickly in the future.

For Canadians generally and P.E.I. in particular the most pressing problem is to understand the steps that the Federal Government will have to take to reduce its massive deficit, in the years to come. Throughout the period from 1975 to the present the Federal Government has been unable to bring its expenditures and revenues into balance largely because it has been unable and unwilling to operate a balanced budget in the generally slow economic conditions that have prevailed. Given the extreme sensitivity of Prince Edward Island to federal actions this is an area of considerable concern.